

Message Text

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SUBJECT:BOI INFLATIONARY PRESSURE CALCULATION
REF: ROME A479

1. WE HAVE EXAMINED THE CALCULATIONS OF THE EFFECTS OF WAGE
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AND EXCHANGE RATE INCREASES ON THE LEVEL OF ITALIAN PRICES
CONTAINED IN REFAIR. THEY ARE MORE THAN MILDLY SURPRISING
AND THE RELATIVE SMALLNESS OF THE IMPACT OF WAGE INCREASES
ON PRICES RUNS COUNTER TO OUR EXPECTATIONS. THE EXERCISE
APPEARS FLAWED ON A NUMBER OF COUNTS. FIRST, THERE IS IN-
SUFFICIENT DISTINCTION BETWEEN ENDOGENOUS AND EXOGENOUS
EXCHANGE RATE CHANGES AND THUS THE DEGREE AND IMPORTANCE OF
EXCHANGE RATE VARIATIONS AS AN INDEPENDENT SOURCE OF INFLA-

N CANNOT BE EVALUATED. SECOND, THE RESULTS ARE AT VARIANCE WITH OTHER RECENT STUDIES OF THE ITALIAN ECONOMY, WHICH NOT ONLY ASSIGN GREATER INFLATIONARY POTENTIAL TO WAGE-RATE CHANGES, BUT WHICH SEE WAGE-RATE CHANGES AS A MORE POTENT INFLATIONARY FORCE THAN CHANGES IN IMPORT PRICES. THIRD, THE CALCULATIONS DEAL VERY SELECTIVELY WITH ONLY CERTAIN COMPONENTS OF GENERAL PRICE INDEXES AND LEAVE UNEXPLAINED BOTH THE SELECTION OF THOSE COMPONENTS AND THE CHOICE OF THE GENERAL PRICE INDEX AS WELL. THE COMPONENTS APPEAR TO HAVE BEEN PICKED SO AS TO MAXIMIZE ESTIMATES OF THE IMPACT OF EXCHANGE RATE DEPRECIATION RELATIVE TO WAGE

INCREASES BY CHOOSING INDICES WHICH HAVE HIGH IMPORT AND LOW WAGE CONTENT.

2. CAREFUL EVALUATION OF THESE RESULTS, HOWEVER, IS IMPOSSIBLE WITHOUT INFORMATION ABOUT PROCESS WHICH GENERATED THEM. WOULD APPRECIATE YOUR EFFORTS TO OBTAIN BRIEF ANSWERS TO QUESTIONS ABOUT EXERCISE LISTED BELOW.

3. WHAT IS THE STRUCTURE OF THE MODEL BEHIND THESE ESTIMATES? (A) WERE THE CALCULATIONS MADE WITH A COMPLETE MODEL OR WITH THE WAGE-PRICE BLOCK OF A LARGE ECONOMETRIC MODEL? (B) WHAT WERE THE PARAMETER ESTIMATES AND HOW WERE THEY OBTAINED? (WHAT, FOR EXAMPLE, WERE THE ASSUMED PRICE ELASTICITIES, THE ASSUMED SUBSTITUTION ELASTICITIES BETWEEN IMPORTS AND HOME GOODS, ETC.?)

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4. IS THE PRICE INDEX WHOLESALE OR CONSUMER AND WHY WERE CALCULATIONS MADE FOR SOME COMPONENTS OF THE INDEX AND NOT FOR OTHERS AND WHY NOT FOR THE OVERALL INDEX?

5. WHAT WERE THE ASSUMPTIONS ABOUT PRICE CONTROLS, MONETARY POLICY AND OTHER VARIABLES AND HOW DO VARIATIONS IN THESE AFFECT THE MODEL'S PREDICTIONS? WERE THE PREDICTED VALUES COMPARED WITH ACTUAL VALUES AND, IF SO, HOW DID THE MODEL TRACK?

6. ONE OF THE DIFFICULTIES IN MAKING CALCULATIONS OF THIS SORT IS IN DISTINGUISHING BETWEEN ENDOGENOUS AND EXOGENOUS CHANGES IN THE EXCHANGE RATE, SO THAT THE ADDITIONAL OR INDEPENDENT INFLATIONARY IMPACT OF A DEPRECIATION MAY BE ASCERTAINED. HOW WAS THE PROBLEM HANDLED BY BOI?

7. IN A RECENT EXPERIMENT, OECD OBTAINED RESULTS WHICH DIFFER SUBSTANTIALLY FROM THE ITALIAN EXERCISE. HOW ARE THESE DIFFERENCES EXPLAINED? (OECD DOCUMENT CPE/WP3 (76)8)

8. HOW IS THE "WAGE INCREASE" DEFINED? IS IT AN ECONOMY-
WIDE AVERAGE OR DOES IT PERTAIN TO A SECTOR SUCH AS
MANUFACTURING?
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